STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

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| IN RE: NEW ENGLAND GAS COMPANY'S | : |
| GAS COST RECOVERY CHARGE | : DOCKET NO. 3436 |

# REPORT AND ORDER

## I. NEGAS' SEPTEMBER 2, 2003 FILING

On September 2, 2003, New England Gas Company ("NEGas"), a division of Southern Union, proposed increases in NEGas' Cost Recovery ("GCR") factors for effect November 1, 2003. Specifically, NEGas proposed to increase its GCR factors on a per therm basis to: $0.8195 for residential and small commercial and industrial ("C&I") customers; $0.8099 for medium C&I customers; $0.8113 for large low load factor C&I customers; $0.7852 for large high load factor C&I customers; $0.8205 for extra large low load factors C&I customers; and $0.7751 for extra large high load factor C&I customers. For a typical NEGas residential heating customer of the former Providence Gas Company ("ProvGas"), this would result in a 7.3 percent increase, or $85 per year, for a total bill of $1,301 per year.[1]

In support of its filing, NEGas submitted the pre-filed testimonies of Michael Harn, Pricing Analyst of NEGas, and Gary Beland, Director of Gas Supply of NEGas. In his pre-filed testimony, Mr. Harn indicated that NEGas' current estimate of the deferred gas cost undercollection, as of October 31, 2003, was $19.9 million. He stated that the undercollection was caused by an increase in NYMEX gas prices and increased consumption as a result of the cold winter.[2]

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[1] This bill impact analysis incorporates NEGas' proposed reduction in the Distribution Adjustment Clause ("DAC") factors effective November 1, 2003. The DAC factors reduction was due to such items as: weather normalization and earnings sharing.
[2] NEGas Ex. 03-2 (Harn's direct testimony, 9/2/03), pp. 9-10.

Mr. Harn stated that the elimination of the undercollection and recovery of projected gas costs would result in a 7 percent increase for the typical residential heating customer. In order to mitigate the impact on customers of the GCR increase, NEGas proposed in the alternative to collect 50 percent of the deferred gas cost balance during the following GCR period beginning November 2004. However, if the deferred gas cost balance were to exceed 5 percent of projected gas costs, NEGas would file an adjustment to the GCR factor to eliminate the undercollection or to reduce the undercollection to no more than 5 percent of projected gas costs. Recovery of 50 percent of the deferred gas cost undercollection would result in a total bill increase of 4 percent to the typical residential heating customer.[3]

In his pre-filed testimony, Mr. Beland stated that the proposed GCR factors are based on the NYMEX strip, as of the close of trading on August 18, 2003, for any purchase of gas supply that is not already locked in under the gas purchasing plan. Mr. Beland next described the Gas Purchasing Incentive Plan ("GPIP"). He indicated that the focus of the GPIP is to lock in future gas prices over an 18 month horizon in order to stabilize prices and to protect customers from the effects of larger price spikes. Furthermore, the GPIP relies on a dollar cost-averaging approach and also provides an incentive mechanism to reward or penalize NEGas for discretionary purchases based on its performance against a dollar cost-averaging benchmark.[4]

## II. DIVISION'S DIRECT TESTIMONY

On October 16, 2003, the Division of Public Utilities and Carriers ("Division") submitted the pre-filed testimony of Bruce Oliver, an outside consultant. In his pre-filed

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[3] Id., pp. 13-16.
[4] NEGas Ex. 03-3 (Beland's direct testimony 9/2/03), pp. 3-4.

testimony, Mr. Oliver indicated that NEGas' typical bill impacts for the GCR increases are based on usage levels that depart from the forecasted average gas use. He also indicated that the magnitude of the GCR increases is not easily observed from NEGas' bill impact analysis. For example, NEGas' proposed GCR increase for residential heating customers is 15.1 percent and many C&I customers face an even larger percentage of GCR increases.[5]

Mr. Oliver stated it is in the Commission's discretion to decide whether to delay recovery of any portion of NEGas' deferred gas cost balance. However, he recommended that the Commission should minimize the deferred gas cost balance that is delayed for recovery in future GCR periods. Other than bill impacts, Mr. Oliver recommended consideration of projected future gas costs, anticipated future DAC levels, weather, and interest when determining what portion of deferred gas costs should be postponed. Beyond this winter, Mr. Oliver suggested there could be considerable upward pressure on natural gas prices. Also, Mr. Oliver speculated that there is a high probability that this winter will be warmer than last winter, which was substantially colder than normal and, therefore, customers' bills will tend to be lower relative to last winter. Furthermore, Mr. Oliver foresaw an upward trend in interest rates over the next year.[6]

Mr. Oliver found NEGas' GCR charges to be properly computed. He also found NEGas' allocations among rate classes for deferred gas costs to be reasonable. However, he determined that the cost responsibilities of FT-1 customers for the 12 months ending June 30, 2003, to be understated. However, he maintained that this does not have a dramatic affect on firm sales customers and should be addressed by the Transitional Sales

[5] Div. Ex. 03-2 (Oliver's direct testimony 10/16/03), pp. 3-5.
[6] Id., pp. 5-9.

Service ("TSS") Tariff. He also proposed the Natural Gas Vehicle ("NGV") charge to be $0.5803 per therm. Furthermore, he found NEGas' marketer transportation charges and the BTU conversion factor to be reasonable. In addition, he found NEGas' proposed tariff in compliance with Order No. 17444 regarding the GPIP to be appropriate. Lastly, he found NEGas' fixed gas supply and storage costs to be reasonable but indicated that in the future NEGas should be required to address the reasonableness of its projected fixed gas supply and storage costs in its annual GCR filing.[7]

## III. NEGAS' RESPONSIVE TESTIMONY

On October 22, 2003, NEGas submitted the responsive testimony of Michael Harn. Mr. Harn indicated that the typical usage levels used for bill impact analysis were developed in Docket No. 3401, and he noted that a typical customer bill may differ from the average usage level for the entire class. Also, Mr. Harn asserted that the impact of a change in the GCR rate is less relevant to a ratepayer than the percentage change in the overall bill. In addition, NEGas agreed that the optimal course of action is to provide for the recovery of deferred gas costs on the most timely basis possible. Furthermore, NEGas still maintained that it would be helpful to establish a 5 percent threshold as a guideline for filing an interim adjustment to the GCR rate. However, NEGas indicated it would not file for an interim rate reduction until the deferred gas cost balance is fully collected. Lastly, NEGas concurred with a NGV charge of $0.5803 per therm.[8]

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[7] Id., pp. 10-18.
[8] NEGas Ex. 03-3 (Harn's responsive testimony), pp. 3-9.

## IV. HEARINGS

Following published notice, a public hearing was conducted on October 23, 2003 at the Commission's offices at 89 Jefferson Boulevard Warwick, Rhode Island. The following appearances were entered:

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| FOR NEGAS: | Craig Eaton, Esq.<br>Cheryl Kimball, Esq. |
| FOR DIVISION: | Paul Roberti, Esq.<br>Assistant Attorney General |
| FOR COMMISSION: | Steven Frias, Esq.<br>Executive Counsel |

Members of the public indicated their opposition to: (1) the GCR increase; (2) support for debt forgiveness; and (3) a lower down payment requirement to resume receiving gas service. NEGas presented Mr. Harn and Mr. Beland as their witnesses. Mr. Harn stated that the GCR increases for C&I customers are larger because gas costs are a larger portion of their bill. Mr. Harn accepted the use of a more recent NYMEX strip to establish GCR rates and acknowledged that the use of a more recent NYMEX strip would lower the proposed GCR rates. Mr. Harn still estimated that the undercollected gas cost balance was $19.9 million. He agreed that for annual reconciliation charges the Commission could review the appropriate uncollectible percentage based on the success of NEGas' recent collection activities. Also, Mr. Harn agreed to resubmit the working capital calculation for the GCR rates utilizing Southern Union's short-term debt rate for the most recent 12 months.[9]

The Division presented Mr. Oliver as its witness. Mr. Oliver stated that the short-term debt rate for the GCR working capital calculation should be the same debt rate used

[9] Tr. 10/23/03, pp. 51, 67-69, 72, 76-80.

for the deferred gas cost balance. He acknowledged that all C&I customers other than small commercial customers can obtain transportation service. Also, Mr. Oliver indicated that the proposed GCR rates are 5 to 10 percent lower than those of other New England gas utilities.[10]

On October 29, 2003, NEGas responded to the Commission's record requests. NEGas submitted a new GCR proposal based on the NYMEX strip of October 27, 2003 and a working capital calculation based on a short-term debt rate of 2.45 percent. The proposed GCR increase that would eliminate the entire undercollection is 5.1 percent, or $62 per year for the typical residential heating customer.[11] Also, the proposed GCR increase that would eliminate 50 percent of the undercollection is 2.1 percent, or $25 per year for the typical residential heating customer.

At an open meeting on October 30, 2003, the Commission reviewed the evidence and adopted NEGas' proposed GCR factors filed on October 29, 2003 that would eliminate the entire undercollection, and on an interim basis adopted the Division's proposed DAC factors, which resulted in an overall increase of 5 percent for the typical residential heating customer or an increase of $60 per year for a total bill of $1,277 per year.

## COMMISSION FINDINGS

At the outset the Commission will address two issues of less significance that arose during this proceeding. First, the Commission recognizes that the cost responsibilities relating to deferred gas costs for FT-1 customers may be understated, but since its impact on firm sales customers is not significant the Commission will not pursue

[10] Id., pp. 145-146, 149-152.
[11] NEGas' October 29, 2003 Record Responses.

the issue at this time. The Commission anticipates that the TSS tariff could address this prospectively. Second, the Commission expects that in future annual GCR filings NEGas will address the reasonableness of its projected fixed gas supply and storage costs.

The primary issue before the Commission in this proceeding was either to approve GCR rates that would eliminate the entire deferred gas costs balance or a lesser amount such as 50 percent of the balance. When it is possible to avoid rate shock, the Commission will eliminate a deferred gas cost balance sooner rather than later. In the past, however, the Commission has deferred gas costs for an extended period. For instance, the Commission required the deferral of gas costs incurred during the winter 2000-2001 through June 30, 2002. This was necessary to avoid rate shock.[12] The Commission also required the deferral of gas costs incurred during the latter half of the winter 2002-2003 beyond the GCR period ending October 31, 2003 because there were not sufficient volumes to eliminate the undercollection without causing rate shock.[13]

In these circumstances, a deferral of gas costs beyond the period ending October 31, 2004 is unnecessary. The elimination of the entire undercollection would result in a 5 percent increase to the typical residential heating customer while elimination of only half the undercollection would be a 2 percent increase. The difference between a 2 percent increase and a 5 percent increase is not sufficient to constitute rate shock.

In addition, the Commission has noticed a long-term trend for higher natural gas prices after the winter of 1999-2000. This is a result of numerous factors such as the growing use of natural gas for new electric generation.[14] These factors have caused a long-term increase in natural gas prices. In essence, the demand for natural gas in the

[12] Order No. 16745, pp. 63-64, 67-68.
[13] Order No. 17444, pp. 21-23.
[14] Div. Ex. 03-2, p. 7.

United States is growing at a faster rate than the supply of natural gas in the United States. As a result, natural gas prices should be expected to climb higher and higher.

Furthermore, the Commission notes that the past winter was colder than normal. In all likelihood, this winter should be warmer than last year. As a result, consumption will be lower and residential heating ratepayers' total bills will be lower so that the deferred gas cost balance could be eliminated without causing rate shock.

In light of the possibility that this winter could be warmer than normal, which could cause natural gas prices to further decline, the Commission requested that during these upcoming winter months, NEGas provide the Commission with monthly reports of the actual and forecasted deferred gas cost balances for the period ending October 31, 2004. If the deferred gas cost balance is eliminated or is projected to be eliminated by October 31, 2004, the Commission could require a decrease in the GCR rates.[15]

Certain members of the public may feel that this Commission is indifferent to increases in NEGas' rates. This is simply false. For instance, in this proceeding, the Commission required that NEGas utilize a recent and lower priced NYMEX strip. In addition, the Commission required that NEGas reduce the short-term debt rate used for the working capital calculations from 4.90 percent to 2.45 percent, which reduced working capital inventory/finance costs by approximately $50,000.[16] Furthermore, the Commission implemented an interim rate decrease of $5.2 million from NEGas' over-

[15] The Commission will not address the issue as to whether to establish a 5 percent threshold guideline for filing an interim rate increase. NEGas can utilize its managerial discretion in filing for an interim rate increase. Of course, the Commission will then exercise its regulatory discretion as to what extent it would approve such increase.

[16] The Commission adopted the 12-month average rate for short-term debt utilized for earnings sharing purposes because it did not differ significantly from the 2.25 percent rate for deferred gas costs. However, if Southern Union's short-term debt rate were to be significantly higher than the tariffed rates for deferred gas costs, especially if it were the result of Southern Union's poor bond rating, the Commission would revisit this issue.

earnings to help offset the GCR increase. These actions had the effect of reducing the increase on the typical residential heating customer's bill from 7.3 percent to 5.0 percent.

Justice Brandeis once stated that "in no other field of public service regulation is the controlling body confronted with factors so baffling as in the natural gas industry."[17] Thus, it is not surprising that certain members of the public may be baffled as to how NEGas' rates continue to climb despite this Commission's best efforts to keep these rates low or stable. As an initial matter, it must be understood that this Commission cannot set the wholesale price of interstate natural gas. The GCR portion of ratepayers' bills was deregulated by the federal government in the Natural Gas Policy Act of 1978.[18] This state Commission has been pre-empted in this arena and must treat these purchased gas costs as a utility operating expense.[19] Therefore, in regards to the wholesale gas cost increases, this Commission has a few options such as: disallowing imprudent wholesale gas purchases, reduce interest charges on any undercollection for deferred gas costs, establishing a gas procurement policy to attempt to shelter residential heating ratepayers from price spikes during the winter, creating a gas procurement plan that imposes penalties on NEGas if it does not take advantage of price dips, or finding savings in NEGas' distribution rates to offset GCR increases. This Commission has done and will continue to do all of the above. It has not been a passive observer who simply blamed the wholesale gas market as prices rose.

In past proceedings relating to wholesale gas costs, the Commission has reduced gas costs by approximately $1.26 million after it conducted a review of the prudence of

[17] Pennsylvania v. West Virginia 262 U.S. 553, 621 (Brandeis dissenting) (1923).
[18] Certain federal authorities could set prices for wholesale natural gas during a shortage. However, no federal action was taken even when gas prices increased dramatically on the NYMEX by closing above $9 during January 2001 and March 2003.
[19] Narragansett Electric v. Burke 119 R.I. 559 (1977).

ProvGas and Valley Gas' gas procurement for the winter of 2000-2001.[20] Also, the Commission approved the development of a gas procurement plan that requires NEGas to purchase gas months in advance in order to ameliorate the price spikes of a colder than normal winter.[21] In addition, this gas procurement plan contains a potential penalty of $500,000 for NEGas if its gas purchases do not take advantage of drops in gas prices.[22]

This is quite a contrast from neighboring Massachusetts. In Massachusetts, gas utilities rely heavily on the spot market so if a winter is very cold and demand is high, the ratepayers are paying for a large amount of gas at a very high price. Furthermore, these gas utilities are not subject to a penalty plan for poor gas purchases. The difference in these two approaches has been made clear over the last four years. Since November 1999, in three of the last four years, NEGas/ProvGas' GCR rates have been below the GCR rates of at least two of three major Massachusetts gas utilities: Bay State, Boston Gas and NStar/Commonwealth. Specifically, NEGas/ProvGas rates were significantly lower in the winter of 2000-2001, and 2002-2003, when dramatic price spikes occurred due to colder than normal weather.[23] This Commission's gas procurement policy has sheltered residential heating customers from extreme price spikes at the time their consumption is highest—extreme cold weather during the winter.[24] Unfortunately,

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[20] Order No. 16745, pp.65-66, 82. This amount includes a 2 percent reduction in interest charges on the deferred gas costs account, which saved ratepayers an estimated $768,000 prior to June 30, 2002. Id. This reduction has continued to save ratepayers on interest charges for the current deferred gas costs balance. It also included a $500,000 contribution from the shareholders to reduce the prior deferred gas costs balance arising from the winter of 2000-2001. Id. at 82.

[21] Order No. 16745, pp. 69-72, & Order No. 17444, pp 25-27, 39-40.

[22] Order No. 17444, pp. 27-38.

[23] During the remainder of the winter after the January 2001 price spike, ProvGas' GCR rate was $0.6979 per therm while Bay State, Boston Gas and NStar's GCR rates ranged from $0.9500 to $1.1123 per therm. Also, during the remainder of the winter after the March 2003 price spike, NEGas' rate ranged from $0.6251 to $0.7120 per therm while Bay State, Boston Gas and NStar's GCR rates ranged from $0.8936 to $0.9911 per therm.

[24] The Commission focuses on residential heating ratepayers in reviewing GCR rates because all C&I customers except small commercial customers are eligible for transportation (competitive) service

because of the legal limitations on this Commission regarding regulation of wholesale gas costs, ProvGas/NEGas' GCR rates for residential heating customers have increased from $0.4531 per therm as of September 30, 2000 to $0.7984 per therm as of November 1, 2003, or approximately a 76 percent increase in three years.[25]

In contrast, this Commission does have extensive authority over NEGas' distribution rates. The primary legal limitation on this Commission in this arena is that the Commission can not set rates that would constitute confiscation of property for Southern Union's shareholders under the 14th Amendment of the U.S. Constitution.[26] In past proceedings affecting distribution rates, the Commission reduced distribution rates by $873,000 as a result of ProvGas' gas procurement for the winter of 2000-2001.[27] Also, in 2002, the Commission rejected NEGas' proposed $7.1 million increase, and instead reduced NEGas' rates by $3.9 million and imposed a three-year rate freeze on distribution base rates.[28] Furthermore, in another proceeding this Commission rejected NEGas' proposed increase of $4.3 million and instead reduced former ProvGas' customers' rates by finding that ProvGas over-earned by $5.2 million from October 2000

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Approximately 182,000 of NEGas' 240,000 customers or 76 percent are residential heating customers not eligible for transportation service.

[25] The monthly closing NYMEX price has more than doubled when the winter of 1999-2000 is compared to the winter of 2002-2003.

[26] See e.g. Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 590 (1944); New England Telephone & Telegraph Co. v. Public Utilities Commission, 116 R.I. 356, 362-364 ( 1976); Valley Gas Co. v. Burke, 446 A.2d 1024, 1031 (R.I. 1982). As long as NEGas is an investor-owned utility, its shareholders have a right to an opportunity to obtain a fair rate of return on their property.

[27] Order No. 16584, pp.16-17 & Order No. 16745, p.82. The Commission adjusted the weather mitigation clause so that ProvGas would not receive an additional $390,000 in distribution revenues because the winter of 2001-2002 was warmer than normal. Order No. 16745, p.82. In addition, the Commission reduced ProvGas' return on equity from 10.9 percent to 10.7 percent, which caused NEGas to return an additional $483,000 in over-earnings. Order No. 16584, pp. 16-17.

[28] Order No. 17381, p. 63.

through June 2002.[29] In addition, the Commission is currently investigating NEGas' over-earnings for the fiscal year ending June 30, 2003 and has implemented an interim rate decrease of $5.2 million. As a result, ProvGas/NEGas' distribution rates for residential heating customers has decreased from September 30, 2000 to November 1, 2003 from $529 per year to $450 per year or approximately a 15 percent decrease in three years.

The Commission has taken the initiative in many proceedings to lower or keep gas rates stable. Continuing its vigilance over gas rates, the Commission is considering a review of NEGas' bill collection activities. Presently, there is a 2.1 percent uncollectibles factor built into gas rates. These uncollectibles may be the result of a few customers gaming the system by paying just enough of their past due gas balance to receive gas service during the winter moratorium. But instead of making reasonable payments on their gas bills, these customers accrue large balances during the winter. These uncollectibles eventually are written off and the customers with these delinquent gas accounts essentially received "free gas". However, this "free gas" for the few comes at a cost to all ratepayers through a hidden 2 percent increase in their bills to pay for uncollectibles or $27 per year for the typical residential heating customer. NEGas' bad debt write-offs were $5.6 million for the fiscal year ending June 30, 2003. Even before the start of this winter season, as of October 31, 2003, the amount of NEGas' bad debt write offs were already $7.3 million.[30]

[29] Order No. 17524, pp. 159-160. The amount of 5.227 million would have been reduced by $483,000 if the Commission had not reduced ProvGas' return on equity from 10.9 percent to 10.7 percent in the earlier mentioned proceeding.
[30] NEGas' November 20, 2003 Record Responses.

NEGas should become more pro-active in its collections activity and in terminating service to customers who have large gas balances. When a customer's balance exceeds $1,000 or approximates the customer's gas bill for a year of service, NEGas should either have the customer significantly reduce his balance with a payment or for his service to end. The Commission is aware that its rules governing termination of gas service may be so generous that it will be difficult for NEGas to implement this policy during the winter moratorium. However, the Commission may revise these rules while reviewing NEGas' collections policy. This could result in a reduction in rates due to a reduction in uncollectibles.[31] Currently, there is already approximately $1.8 million in rates to assist low income households through a combination of aid to LIHEAP customers and weatherization. There is no need for an implicit program of "debt forgiveness" to continue through a policy of allowing for an uncollectible factor of 2.1 percent in rates. The Commission can not on one hand scrutinize and pursue over-earnings by NEGas while turning a blind eye to a growing uncollectibles problem. Over-earnings and excessive uncollectibles both cause rates to be higher than necessary thereby making it more difficult for ratepayers struggling to pay their bills to continue to make payments. The bill has come due on those receiving "free gas".

Accordingly, it is

(17606) ORDERED:

1. The Gas Cost Recovery factors filed by NEGas on October 29, 2003, set forth on a per therm basis, of: $0.7984 for residential and small C&I customers, $0.7888 for medium C&I customers, $0.7902 for large low

[31] The Commission is not contemplating revising these rules as it relates to the seriously ill, handicapped, elderly or temporarily unemployed.

load factor customers, \$0.7641 for large high load factor customers, \$0.7994 for extra large low load factor customers, and \$0.7540 for extra large high load factor customers are approved for effect November 1, 2003 through October 31, 2004.

2. The Gas Marketer Transportation factors filed by NEGas on September 2, 2003 of: \$0.043 per therm for FT-2 Firm Transportation Marketer Gas Charge, \$0.0022 per percent of balancing elected per therm for Pool Balancing Charges, and weighted average upstream pipeline transportation cost of \$0.1034 per therm of capacity, are approved for effect November 1, 2003 through October 31, 2004.

3. The Natural Gas Vehicle Rate filed by NEGas on October 22, 2003 of \$0.5803 per therm, is approved.

4. The revision to the tariff language for the Gas Cost Recovery Clause filed by NEGas on September 2, 2003, is approved.

5. NEGas shall comply with all other findings and instructions contained in this Report and Order.

EFFECTIVE IN WARWICK, RHODE ISLAND, ON NOVEMBER 1, 2003, PURSUANT TO AN OPEN MEETING DECISION ON OCTOBER 30, 2003. WRITTEN ORDER ISSUED NOVEMBER 21, 2003.

PUBLIC UTILITIES COMMISSION

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Elia Germani, Chairman

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Kate F. Racine, Commissioner

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Robert B. Holbrook, Commissioner